Service Date: May 6, 1986

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

IN THE MATTER Of The Application) Of The CITY OF GLASGOW To Increase) Water Rates And Charges.)	UTILITY DIVISION DOCKET NO. 85.9.38 ORDER NO. 5191

APPEARANCES

FOR THE APPLICANT:

John Doubek, Attorney at Law, Livery Square, 39 Neill Avenue, Helena, Montana 59601.

FOR THE COMMISSION:

Robin McHugh, Staff Attorney, 2701 Prospect Avenue, Helena, Montana 59620.

Before:

Danny Oberg, Commissioner and Hearing Examiner

BACKGROUND

1. On September 13, 1985, the City of Glasgow (Applicant or City) filed an application with this Commission for authority to increase rates and charges for water service to its customers in the Glasgow, Montana area. The Applicant requested an average increase of approximately 90 percent which constitutes an increase of approximately $300,500 in annual revenues.

2. On February 19, 1986, pursuant to notice of public hearing, a hearing was held in the Courtroom of the Valley County Courthouse, Glasgow, Montana. The purpose of the hearing was to consider the merits of the Applicant's proposed water rate adjustment. At the close of the public hearing, all parties waived their rights to a proposed order and stipulated to authorize the Commission to issue a Final Order in this Docket.

ANALYSIS AND FINDINGS OF FACT

3. At the public hearing the Applicant presented the testimony and exhibits of the following witnesses:

   Roger Larsen, Chairman Water Study Committee
   Ramona Tow, City Clerk/Treasurer
   Robert Benson, Consulting Engineer
   Ray Moore, Consulting Engineer

These witnesses testified relative to: the need for the proposed capital improvements, the estimated cost of the proposed capital improvements, the financing of the proposed capital improvements, debt service obligations and rate structure.

4. During the course of the public hearing 13 public witnesses appeared and offered testimony regarding the City's proposed capital improvements and rate increase application. The majority of the public witnesses supported the City's proposed capital improvement program because it would improve the quality of the water and also increase the available supply of water negating the need for the City to impose severe water use restrictions.

Several of the consumers expressed concerns regarding the City's proposed rate structure indicating that it was their belief that the proposed minimum charge placed too great a revenue burden on low volume consumers.

CAPITAL IMPROVEMENT PROGRAM

5. The City in its application has set forth a proposed capital improvement program for the water utility. The total estimated cost of the capital improvement program as outlined by the City is $2,880,000. The following Table 1 sets out the proposed capital improvements to the water system and their estimated cost.

TABLE 1

1. New Supply Line	$2,592,000
2. Treatment Plant Improvements	$ 288,000
TOTAL	$7,880,000

6. The City proposes that the capital improvement program under consideration in this Docket be funded through the execution of a loan agreement with the Montana Department of Natural Resources, which is administering a funding program passed by the 1983 Montana Legislature.

7. In its proposed capital improvement program the City anticipates the construction of a new supply line connecting the City's water utility with the Missouri River. This new supply line will tie into an existing line which draws its water from the Fort Peck Reservoir and is owned by the Valley Industrial Park.

At present the City of Glasgow water utility receives its of nearby wells. The testimony in water supply from a series this case indicated that this supply source was no longer adequate to meet the needs of the City because the City was experiencing declining well yields and well failures. Due in part to the inadequacy of the City's current source of supply the City has found it necessary to implement water use restrictions during periods of high demand e.g. summer irrigation season.

Further testimony indicated that test drilling to determine the feasibility of well field expansion produced unsatisfactory results. The test drilling results produced information reflecting a declining aquifer and a diminishing source of water south of the City. The test wells also revealed that the water quality was the same as obtained from the existing wells, which are relatively high in mineral content, adversely affecting the quality and taste of the water.

8. The above recited deficiencies in the City's existing water system prompted the City Council to initiate an investigation into an alternative source of water supply for the water system. This investigation determined that the Missouri River was the best available alternative source of water supply for the system. The City's witnesses indicated that construction of the pipeline would increase the City's maximum available supply of water to 3,000,000 gallons a day which should be sufficient to meet the projected daily water demand on the system. The City's witnesses also testified that the quality of the water obtained from the Missouri River would be vastly superior to the water supply currently in use by the City.

9. With the conversion of its source of supply from a ground water source to a surface supply source the City will have to make modifications to its existing water treatment facility. These modifications will have to be made in order to accommodate the differing treatment requirements of a ground water source of supply versus a surface source of supply.

10. As an aside to the City Council's decision to construct a pipeline converting its water system to a surface source of supply, it is appropriate to note that prior to the filing of its case with the Commission, it placed the matter of the proposed capital improvements and attendant rate increase before the voters. This was the only matter on the September 10, 1985, primary election ballot and 59 percent of the voters turned out with 80 percent casting a vote in favor of the capital improvements.

11. The Commission finds, based upon the testimony in this Docket, that the capital improvement program as proposed by the City is reasonably prudent and, therefore, accepts the improvements as outlined. The Commission also accepts the City's estimated cost of 52,880,000 as being a reasonable estimate of the construction costs.

DEBT SERVICE

12. The City proposes to finance the capital improvement program outlined in the preceding Findings of Fact through the issuance of revenue bonds with the purchaser being the Montana Department of Natural Resources and Conservation (DNRC).

The City is proposing the issuance of $3,200,000 in revenue bonds to be repaid over a period of 20 years with an interest rate of 6.29 percent during the first 5 years and 9.29 percent for the remaining 15 years. Under this financing, the City proposes a bond reserve in an amount equal to one semi-annual principal and interest payment on the bonds and provide a debt service coverage ratio of 125 percent. (The proposed bond issue amount exceeds the construction costs by $320,000 because included in the issue, are the bond issuance costs and capitalization of the bond reserve from bond proceeds)

13. The Applicant has a current outstanding water revenue bond with an annual principal and interest payment of approximately $41,500 and a present coverage ratio requirement of 150%. The City does not anticipate retiring this bond issue with the issuance of the proposed revenue bond issue. Therefore, the City will be incurring bond payments that are additional to those just described.

14. Since the City will not be retiring the current outstanding revenue bond it will have to comply with the requirements outlined in Ordinance No. 731 (current Revenue Bond Ordinance) regarding the issuance of additional revenue bonds. The Commission's examination of this Ordinance indicates that the only prerequisite for issuance of additional revenue bonds is that the new bond issue be made subordinate to the bonds authorized in Ordinance No. 731.

15. In any sale of municipal bonds, the purchasers of the bonds must be assured that their investment is secure. To provide this security, the municipality makes a promise, called a covenant, to do certain things that will ensure that it will always be able to pay the bond's principal and interest as they come due. The proposed revenue bond includes covenants agreeing to establish a bond reserve fund in an amount equal to one semi payment on the bond, which is to proceeds and provide

a coverage annual principal and interest be capitalized from the bond ratio of 125 percent.

16. The Commission finds the bond covenants, establishment of a reserve fund and the 125 percent coverage ratio, to be among the standard requirements for the issuance of revenue bonds and therefore, accepts the requirements.

17. The Commission finds the issuance of $3,200,000 in revenue bonds with a maximum term of 20 years and a maximum interest rate of 9.29 percent with the requirements that the City establish a bond reserve in an amount equal to one semi annual principal and interest payment on the bonds and provide a debt service coverage of 125 percent, to be reasonable.

18. When the City completes the sale of the proposed revenue bond it will incur a maximum annual principal and interest payment on all outstanding revenue bonds of approximately $321,700. It will also incur the obligation to have a net operating income of at least $91,625 to meet the requirements that it achieve the coverage ratios outlined in the two outstanding revenue bond ordinances. To determine the required net operating income, operation and maintenance expense, as well as debt service, are subtracted from the total revenues of the utility. The required net operating income is calculated by multiplying the annual principal and interest payment on outstanding bonds by the prescribed coverage ratio (($44,800 x .50%) + ($276,900 x .25) = $91,625).

RECURRING ANNUAL CAPITAL IMPROVEMENTS

19. The City, in this filing, is proposing that the Commission grant revenues which are sufficient to allow funding of recurring annual capital improvements (raci) to the water system. Granting revenues which are sufficient to allow for funding of raci, in the City's view, would enhance the City's ability to provide reasonably adequate water service and maintain the integrity of the current facilities.

20. In its filing the City included raci funding at an average annual level of approximately $113,000. Funding raci at this level would allow the City to continue its on-going main replacement program and cover routine capital improvement

costs incurred in the normal operation of the utility.

21. The Commission fully supports the adequate funding of raci when that funding is tied to a schedule of contemplated system improvements. The Commission finds that adequate funding of this type of account is both prudent management and regulation, in that it allows for proper system maintenance; therefore, the Commission finds the City's request for annual funding in the amount of $113,000 to be reasonable.

22. The grant of funding for this account will be in lieu of recognition of the coverage ratio requirement in the Commission's revenue need calculation. The reason that this funding will be recognized instead of the coverage ratio is due amount required to meet to the fact that raci funds exceed the coverage ratio test prescribed in the bond ordinances and also would be considered net income of the utility, as defined in the ordinances, therefore satisfying requirement.
the coverage ratio

OPERATION AND MAINTENANCE EXPENSE

23. In its application the City has projected operation and maintenance expenses totaling $228, 800. The projected operation and maintenance expenses were not challenged by any party participating in this proceeding and therefore, are accepted by the Commission.

REVENUE NEED

24. The City indicated that, under present rates effective January, 1985, user charges would generate approximately $333,900 in annual revenues. The test period user charge revenues are not a contested issue in this case and are, therefore, accepted by the Commission.

25. The City's water department has sources of revenue other than user charges, which include:

Miscellaneous Operating Revenue	$ 9, 900
Interest Income	$19,700
Total Other Income	$29,600

The "Other Income" as presented by the Applicant appears to from these fairly represent revenues that can be anticipated from these sources and is accepted by the Commission

26. The Commission, based upon Findings of Fact Nos. 24 and 25, finds the total test period operating revenues are $363,500.

27. The Commission, based upon Findings of Fact contained herein, finds that the Applicant should be allowed to increase annual revenues by $300,000. This requirement is calculated as follows:

Operating Revenues	$363.500
Less:	
Operating Expenses	$228,800
Debt Service	321,700
Recurring Annual Improvements	113,000
Total Revenue Requirement	$663,500
REVENUE DEFICIENCY	$300,000

RATE DESIGN

28. In its application, the City has proposed the implementation of a rate structure that includes a minimum monthly charge and a commodity rate per hundred cubic feet (ccf) of consumption beyond the monthly minimum allowance. The minimum monthly charge and consumption allowance included in the minimum bill varies with meter size.

The City also proposes the continuation of a fire hydrant rental fee to recover the cost of providing fire protection.

29. The Applicant presented a traditional cost of service study utilizing the base-extra capacity method of cost allocation. In the base-extra capacity method, all costs are separated into components of base cost, extra capacity costs, customer costs and direct fire protection costs.
This method allocates the costs of service (capital costs and operating costs) between the utility's base or average day and the extra capacity required to meet maximum day and peak hour system requirements. The base costs include those costs that tend to vary with the amount of water produced. The extra capacity costs include the additional costs incurred as a result of varying system load conditions and the need to meet demands in excess of average day. The base costs are allocated to customer classifications in relation to the water consumed by each class. The extra capacity costs are allocated in relation to the excess capacity required by each class of customers for maximum day and peak hour requirements.

Customer costs and fire protection costs are generally directly assignable and include such items as meter reading, billing, collecting, accounting, fire hydrant maintenance and capital related expenditures for fire protection.

30. The major concern expressed by consumers regarding the Applicant's proposed rate structure was the inclusion of a $10.70 monthly customer charge in the minimum monthly bill. To insure that this concern was adequately addressed City witnesses were cross-examined regarding the development of the monthly customer charge proposed by the City.

The cross-examination revealed that the customer charge as presented was designed to recover customer costs and a portion of the water utility's fixed costs attributable to debt service. Customer costs as defined in the cost of service study "consist of meter and service connection related expenses, and customer billing and accounting costs." When the previously defined customer costs are examined separately the Applicant's witnesses indicated that the monthly customer cost approximated $2.36 per month which is significantly lower than the charge proposed by the City in its rate structure.

31. The testimony in this Docket clearly indicates that the monthly customer charge proposed by the Applicant is not purely cost of service based and that cost components other than customer related costs are included in its construction. The City's witnesses in their testimony indicated that implementation of the higher than calculated customer charge was subjective and that the reasoning for doing so was to minimize the effect water conservation and customer resistance to rate increases would have on the consumption charge in future proceedings, and to provide a greater revenue stability for the water utility.

32. Even though the customer charge proposed by the City will generate revenues in excess of those needed to recover customer related costs, the Commission is of the opinion that the City has presented reasonable justification for its implementation.

33. The major contributing factor to the City's need for increased rates and charges is its proposed issuance of additional revenue bonds for construction of capital improvements to the water system. With the issuance of the revenue bonds the City will incur a total annual debt service obligation of approximately $413,325, which represents approximately 60 percent of the utility's total annual expenses.

If the Commission were to assign the entire debt service cost recovery responsibility to the commodity charge this charge would increase from the present rate of $. 80 per ccf to $2.16 per ccf. With this magnitude of increase in the commodity charge customer resistance to rate increases would cause a significant decrease in consumption, because of the consumers desire to minimize monthly water bills. The decrease in total consumption on the part of the consumer in its effort to minimize water bills, would necessitate the implementation of additional water rate increases in the near future because the entire revenue generating ability of the utility would be dependent upon water volumes.
Transferring a portion of the debt service cost recovery responsibility to the customer charge, as proposed by the City, appears to be reasonably prudent in

this instance. It lowers the increase in the commodity rate thus reducing customer the revenue stability of the utility and resistance, improves minimizes the effect water conservation and customer resistance would have on the consumption charge in future proceedings.

34. The Commission finds that the City's rate design proposal is equitable and fairly recovers the cost of providing service to the various customer classifications and, therefore, accepts the proposal.

CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises jurisdiction over the parties and subject matter in this proceeding. Title 69, Chapters 3 and 7, MCA.

2. The Montana Public Service Commission has afforded all interested parties in this proceeding proper notice and an opportunity to participate. Section 69-3-303, MCA, Title 2, Chapter 4, MCA.

3. The rates approved herein are reasonable, just and proper. Section 69-210, MCA.

ORDER

NOW THEREFORE, IT IS ORDERED THAT:

1. The City of Glasgow shall file tariffs consistent with the Findings of Fact for Docket No. 85.9.38 contained herein.

2. The City of Glasgow is authorized to issue a revenue bond in the amount of $3,200,000 with the requirements as outlined in Finding of Fact No. 17.

3. The City is authorized to file increased rates designed to generate additional annual revenue in the amount of $300,000. The rates shall become effective upon Commission approval which approval date will coincide with the Department of Natural Resources and Conservation's loan commitment date.

4. A full, true, and correct copy of this order shall be sent forthwith to the Applicant and all other appearances herein.

DONE IN OPEN SESSION at Helena, Montana, this 5th day of May, 1986, by a vote of 5 to 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

HOWARD L. ELLIS, Commissioner

TOM MONAHAN, Commissioner

DANNY OBERG, Commissioner

JOHN B. DRISCOLL, Commissioner

ATTEST:

Trenna Scoffield, Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within (10) days. See 38.2.4806, ARM.